Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	WC Docket No. 10-90
Connect America Fund	)	

INITIAL COMMENTS OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES ON RATE OF RETURN STAFF REPORT

Somewhat more than twenty years after it last set a rate-of-return ("RoR") for incumbent local exchange carriers ("ILECs"), the Federal Communications Commission ("FCC" or "Commission") is looking to re-examine the authorized RoR.[1] The Staff of the FCC's Wireline Competition Bureau ("WCB") issued a Staff Report[2] that recommends a reduction in the authorized RoR from the 11.25% set in 1990[3] to somewhere in the range of 8.06%-8.72%.[4] Pursuant to Public Notice, comments on the Staff Report are due July 25, 2013, with Reply Comments due August 26, 2013.

The National Association of State Utility Consumer Advocates ("NASUCA")[5] provides

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[1] *Connect America Fund et al.*, WC Docket No. 10-90 et al., Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663, 17983-84, para. 900 (2011) (*USF/ICC Transformation Order*), *pets. for review pending sub nom. In re: FCC 11-161*, No. 11-9900 (10th Cir. filed Dec. 8, 2011) at 17870, ¶¶ 639-640.

[2] DA 13-1111 (rel. May 16, 2011) (Staff Report").

[3] *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, Order, 5 FCC Rcd 7507 (1990) (1990 Represcription Order).

[4] Staff Report at i.

[5] NASUCA is a voluntary association of advocate offices in more than 40 states and the District of Columbia, incorporated in Florida as a non-profit corporation. NASUCA's members are designated by laws of their respective jurisdictions to represent the interests of utility consumers before state and federal regulators and in the courts.

these comments to emphasize two points:

- Given the many years since the RoR was set at 11.25% – and the concomitant amount of time that the authorized RoR has been too high – Staff's recommendation to use the upper half of its range of reasonableness[6] is itself unreasonable. The lower half of the range – indeed, the bottom point of the range (7.39%)[7] should be used.
- Staff's description of the purposes of the authorized RoR – as used only for "roughly 1200 [ILEC] study areas subject to rate-of-return regulation… to determine interstate common line rates and special access rates for rate-of-return incumbent LECs and is also used in calculating some forms of support provided by the Universal Service Fund…."[8] is short-sighted. Given the substantial lowering of the authorized RoR, the RoRs used in setting unbundled network element ("UNE") rates for larger carriers, and also used in setting rate caps and determining exogenous changes for price cap carriers, should be re-examined, to lower customers' rates.

Despite the claims of those in the industry that the calculation of an authorized RoR is irrelevant in this new intermodal IP-enabled world,[9] under the FCC's current rules the RoR remains important. After all, as the Staff states,

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Members operate independently from state utility commissions as advocates primarily for residential ratepayers. Some NASUCA member offices are separately established advocate organizations while others are divisions of larger state agencies (e.g., the state Attorney General's office). NASUCA's associate and affiliate members also serve utility consumers but are not created by state law or do not have statewide authority.

[6] Staff Report at i.

[7] Id.

[8] Id., ¶1 (footnotes omitted).

[9] cite

In keeping with its statutory obligation to ensure that rates are just and reasonable, the Commission must set the rate of return high enough to allow carriers to maintain their credit-worthiness and attract capital, but no higher. If the rate is too high, customers pay unreasonably high prices both through direct payments to carriers and through excessive Universal Service Fund fees.

On behalf of the consumers that its members (by law) represent, NASUCA urges the Commission to expeditiously represcribe the RoR, recognizing all the ramifications of that represcription.

NASUCA will not be delving into the intricacies of determining a reasonable RoR.[10] But that does not mean that the process is unimportant; the end result of the process is crucial, as WCB Staff state:

> One thing that has not changed is the critical importance to both the industry and customers that the Commission establish an appropriate rate of return. The [weighted average cost of capital] WACC is the minimum rate of return required to attract capital to an investment (*e.g.*, by incurring debt and/or selling stock). The rate of return must be high enough to provide investors confidence in the "financial integrity" of a carrier, so that it can maintain its credit-worthiness and attract capital. It "should not be higher than necessary for this purpose," because this would result in unreasonably high prices for customers and excessive demands on USF. The rate of return should also be "commensurate with returns on investments in other enterprises having corresponding risks." As the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) has recognized, "rate of return decisions are appropriately treated as policy determinations in which the agency is acknowledged to have expertise."[11]

The Staff Report's use of "the publicly-traded rate-of-return incumbent LECs as proxies for rate-of-return incumbent LECs generally to determine the WACC"[12] is reasonable. So is, for this purpose, the use of both the Capital Assets Pricing Model ("CAPM") and the Discounted Cash Flow ("DCF") models to set the range of reasonableness for the cost of equity.[13] Staff's determination of a zone of reasonableness is consistent with Commission precedent; the

[10] Which is not to say there are no questionable aspects to the Staff's methodology, use of an excessive DCF growth rate in particular.

[11] Staff Report, ¶6 (footnotes omitted).

[12] Id. at i.

[13] Id.

Commission itself must determine the unitary rate of return to use.[14]

NASUCA's key concern is that the represcription **get done.**[15] The almost 300 basis-point difference between the current authorized RoR (11.25%) and the mid-point of Staff's recommendation (8.39%) is glaring and demands change.

The difference is even greater if, as NASUCA recommends, the Commission adopts the low point of Staff's overall range of 7.39%-8.72%. Staff supports its use of the upper half of that range due to "current historically-low interest rates and the infrequency of represcription....."[16] Actually, these rationales – particularly infrequency, as discussed further below – could also be used to justify using the lower half of Staff's range.

Staff also uses a times-interest-earned ("TIE") analysis to show that returns in the upper half of the range will meet TIE benchmarks and will provide adequate interest coverage.[17] Yet the analysis addresses only RoRs of 8% and above.[18] Staff does not show that returns at the lower point of its range –7.39% – will be inadequate. And Staff also misses the crucial point that an authorized RoR should not **guarantee** earnings at that level for a carrier; the RoR only affords the carrier a reasonable **opportunity** to earn at that level.

Staff's point about the length of time between represcriptions – used as a rationale for selecting the top half of the RoR range – is actually a reason for going much lower. The Commission has not exactly been besieged by carriers' requests to raise the authorized RoR, which implies that most were satisfied with the 11.25% **and have been satisfied for many**

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[14] Id., ¶ 5.

[15] NASUCA reserves the right to dispute other commenters' arguments on the Staff's methodology.

[16] Staff Report at i.

[17] Id., ¶¶119-137; see esp. ¶¶ 129, 137.

[18] See id., ¶¶ 132, 134, 136.

years. Thus the levels of rural carriers' USF funding have long been calculated at a level based on an excessive RoR, and the UNE rates of large carriers, and the rates of price cap carriers, have also likely been based on excessive RoRs.

The Staff's proposed RoR range shows that the risk of being in the ILEC industry right now is manageable. Clearly, the excessive RoR of previous years has benefited the carriers. The carriers do not need the subsidy from excessive rates charged to retail and wholesale customers to maintain an adequate return. This means that the authorized RoR should be set at the lowest point of the range, in recognition of these past over-collections.

The (current) historically low interest rates and the infrequency of represcription,[19] two of the Staff's rationales for using the higher half of the reasonable RoR range, actually support using a lower rate. One would hope that the Commission would represcribe more often than once every twenty years. If interest rates rise significantly, a timely represcription would ease that problem.[20]

As noted above, the Staff focuses on the impact that represcribing the authorized RoR will have on rural carriers' USF. But RoRs are also used in setting UNE rates for larger carriers,[21] and for price cap carriers in setting rate caps and determining exogenous adjustments.[22] Rural carriers should not be the only ones required to reflect the economic situation of 2013,

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[19] Staff Report at 50

[20] Staff's third rationale – its TIE analysis – is flawed as describe above.

[21] *In the Matter of Petition of Worldcom, Inc. Pursuant to Section 252(e)(5) of the Communication Act for Preemption of the jurisdiction of the Virginia State Corporation Commission Regarding Disputes with Verizon Virginia Inc., and for Expedited Arbitration*, CC Docket No 00-218, Memorandum Opinion and Order, DA 03-2738, released August 29, 2003 ("*Virginia Arbitration Order*").

[22] 47 *C. F. R.* Section 69.3 requires the annual filing of access tariffs and those tariffs must reflect adjustments to the Price Cap Index ("PCI") to reflect exogenous changes under Section 61.45. Exogenous changes are defined in Section 61.45(d), which specifies how the PCI is adjusted for exogenous events.

rather than 1990; larger carriers' customers should also benefit from a lowered RoR.[23]

NASUCA appreciates the opportunity to comment on these matters, and commends the views set forth herein to the Commission's attention.

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[23] The higher earnings of RBOCs (see Staff Report, Appendices H. and I.1.) show an even greater need to apply the lowered authorized RoRs to them.